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Jessica Hertz
Office of Management and Budget
Washington, DC

Dear Ms. Hertz:

This letter responds to your March 4 inquiry soliciting comments on the President's regulatory review process. Below I offer some suggestions on: (1) the appropriate scope of regulatory review; (2) the use of cost-benefit analysis in regulatory review; and (3) how one might address concerns about anti-regulatory bias in regulatory review.

Scope of Regulatory Review

1. Guidance Documents

As you are aware, Executive Order 12866 does not apply to so-called "guidance documents" or "interpretive rules"—statements issued by an agency that lack the force of law, but which may have a significant practical impact. President George W. Bush's Executive Order 13422 (now withdrawn) expanded the scope of OMB regulatory review to cover significant guidance documents. Although I support the withdrawal of most other aspects of E.O. 13422, I believe that the expansion of regulatory review to cover significant guidance documents was desirable and should be reinstated, for two reasons.

First, if the purpose of regulatory review is to ensure that significant agency actions are consistent with the President's priorities and the actions of other agencies, there is no clear reason why certain agency actions should be excluded simply because they lack formal legal force. To be clear, regulatory review should extend only to guidance documents and interpretive rules that are expected to have a significant impact (the same standard applied to legislative rules). Most guidance documents will probably not satisfy this criterion, so concerns that covering such documents would greatly expand the scope and intrusiveness of OMB review are in my view misplaced.

Second, excluding interpretive rules and guidance documents from OMB review gives agencies even stronger incentives to act through these devices, rather than through notice-and-comment rulemaking. Such behavior is problematic, perhaps particularly so for the subset of interpretive rules or guidance documents that would have a substantial

practical impact. It is unwise to design the OMB review process in a way that gives agencies an additional incentive to avoid notice-and-comment procedures.

2. Independent Regulatory Commissions

Although E.O. 12866 requires independent commissions to participate in the regulatory planning process, it exempts these commissions from the regulatory review process. I recommend that the new order on regulatory review subject independent commissions to the same review process mandated for executive agencies in what is now Section 6 of E.O. 12866, but that independent commissions remain outside the scope of what is now Section 7 of E.O. 12866 (which gives the President the authority to resolve disputes between OMB and agencies, should they arise).

The practical case for requiring independent commissions to provide information to OMB on significant regulations, including cost-benefit analysis, is straightforward: If the OMB consultation process is thought to improve the quality of regulation, then that consideration militates in favor of extending the review process to independent commissions. The legal case for extending regulatory review to the independent commissions is also, in my view, straightforward, in that Section 6 of E.O. 12866 does not give OMB or the White House the formal power to “veto” an agency regulation. As a formal matter, Section 6 only requires agencies to provide information, and creates a formal mechanism for OMB to offer its views to the agency. Even if one believes that it is constitutionally permissible for Congress to create “independent” regulatory commissions, for which the President’s removal authority is limited, this independence does not and should not insulate these commissions from presidential requests for information about their activities, including detailed information about the costs and benefits of their regulatory proposals.

Applying the equivalent of Section 7 of E.O. 12866 to independent commissions is more legally problematic, however, because it appears to give the President the authority to order an agency to comply with OMB’s directives (e.g., not to proceed with a regulation that OMB believes is not cost-justified). I would recommend abstaining from asserting a presidential authority to resolved disputes between OMB and the independent commission (except that the President should have the authority to insist that any agency, including an independent commission, provide the White House with any pertinent information it requests.)

Cost-Benefit Analysis

Cost-benefit analysis is controversial in some quarters, but I recommend that OMB continue to require agencies to perform cost-benefit analyses of regulatory proposals when doing so is permitted by law. Other commentators have offered a variety of thoughtful comments for improving the practice of cost-benefit analysis. I would like to add a handful of additional suggestions.

1. Provide Full Information on Probability Distribution of Possible Outcomes

Reducing all available cost-benefit information to a single number (such as a mean net benefit) suppresses both valuable information and may create a false sense of precision. Information about net regulatory benefits should therefore always include a quantified measure of the uncertainty surrounding the estimate. Ideally, agencies should present cost-benefit analysis results to OIRA in a form of an estimated probability density function (perhaps presented in graphical form), along with all three measures of the central tendency of the distribution (mean, median, and mode), and the variance. If this proves too demanding, then at the very least cost-benefit estimates should be given as ranges (for instance, 90% confidence intervals) rather than as misleading point estimates. Some have expressed the concern that allowing (or requiring) agencies to report cost-benefit analysis in distributions or ranges rather than point estimates will allow agencies to “evade” the cost-benefit analysis, or to undermine the rigor that is supposed to be associated with such analyses. I disagree. Indeed, I believe such objections have it backwards. If the confidence interval for net regulatory benefits straddles zero, then the simple fact is that the existing data cannot tell us, at that level of confidence, whether the true net benefits are positive or negative. Whether agencies should proceed with new regulatory initiatives under those circumstances depends on the burden and standard of proof. But we should not impose an artificial constraint on agencies—requiring them to regulate or refrain from regulating—on the basis of information that has a very large change of being wrong.

2. Allow Appropriate Experimentation and Learning

Following on the preceding comment, in some cases agencies should be allowed to proceed with new policies that have negative expected net benefits, if there is sufficient uncertainty regarding the estimate and the agency will have the opportunity to revisit the policy choice as new data becomes available. To illustrate with a stylized example, imagine an agency considering two options: a new policy regulation (*R*) and the status quo (*Q*). *Q* generates a certain benefit of +1; the agency’s cost-benefit projections indicate there’s a 50% chance that *R* will generate net benefits of +10, and a 50% chance it will generate net benefits of -10. Viewed from a static perspective, *Q* is superior to *R*. But if the agency can learn and adjust, and if the future is not discounted too steeply, *R* may be superior to *Q*: There’s a 50% chance that *R* will be a disaster (-10), in which case the agency can revert to *Q* and suffer only a short-term cost, while there’s a 50% chance *R* will be a huge success (+10), drastically improving welfare in the long term. (In a two-period model with no discounting, the expected payoff from selecting *Q* is 2, while the expected payoff from selecting *R* in the first period and then changing policy if it fails is 5.5 ((50% x 20) + (50% x -9)).)

The essential point is that, at least where policy change is not too difficult and agencies are likely to acquire reliable additional information after a new policy goes into effect, agencies should be allowed—and encouraged—to experiment. Put another way, a sensible cost-benefit analysis should incorporate (explicitly or implicitly) the additional information that different courses of action might generate. This point is related to the

suggestion above that agencies should provide information on the distribution, rather than simply the mean estimate: It is easier to justify experimentation when the information shows at least a reasonable chance of higher-than-expected benefits.

3. Create a More Formalized Mechanism for Retrospective Cost-Benefit Analysis

OMB regulatory review, as currently practiced, emphasizes the need for a cost-benefit analysis immediately before a new regulatory policy is enacted. But, following on the previous comment, information about regulatory effectiveness often does not become available for some time after the new policy is in place. While it would probably not be feasible to conduct a regular after-the-fact cost-benefit analysis of every significant regulation, there ought to be some regular procedure for conducting a retrospective cost-benefit analysis on a sample of regulations. Such retrospective analysis would serve two valuable functions. First, it would generate information about the accuracy of the initial cost-benefit analysis (which can then be used to improve the evaluation process, and provide feedback on whether prospective cost-benefit analysis is working well enough to retain). Second, it would provide information on whether the specific regulation should be retained, abandoned, or modified. One might even imagine a system in which OMB would require an agency commitment to a retrospective cost-benefit analysis some number of years out as a condition of signing off on the regulatory proposal in the first place.

4. Create a Mechanism for Sharing Information, But Don't Mandate Uniformity

I share the concerns of those commentators who have pointed out that different agencies often use wildly different discount rates, different estimates of the value of a statistical life, and so forth. I would support the creation of a mechanism for agencies to share information about these and other assumptions with one another. This would enable agencies to aggregate information, identify outliers, and achieve a higher degree of uniformity. I would not, however, support OMB-mandated uniformity for things like discount rates or statistical life valuations. This is principally because there is so much uncertainty about these matters, with constant changes in thinking and development of new data. Under those conditions, a decentralized system might be more efficient in acquiring, aggregating, and disseminating new information. OMB should compile information about the practices of different agencies, but individual agencies should have some freedom to revisit these issues and to report any changes in assumptions or estimates to the centralized information repository. This would entail some loss of uniformity, but I think the pressures on agencies to achieve a greater degree of uniformity will be sufficiently strong that this is a cost worth bearing. Locking in a single set of government-wide numbers by fiat risks substantial error costs.

Anti-Regulatory Bias

I agree with other commentators who have emphasized concerns that OMB regulatory review may create an anti-regulatory bias. There are two principal sources of such bias. First, cost-benefit analysis can be—and in the past has been—designed or

manipulated so as to produce anti-regulatory results. But this is not an inevitable feature of cost-benefit analysis, and many commentators have provided an array of useful suggestions for reforming the practice of cost-benefit analysis to address this problem. The second problem derives from the asymmetric structure of OMB review, and is for that reason more difficult to fix: Because OMB reviews agency *action*, but typically does not review agency *inaction*, and because OMB review imposes costs on agencies (in the form of delay and additional analytical requirements), OMB review is a deterrent to agency action. Strictly speaking, this structural asymmetry creates a *status quo bias* rather than an *anti-regulatory bias*, but in many cases this amounts to the same thing.

While it is clearly infeasible for OMB to review every agency failure to act, it would be desirable for the new executive order on regulatory review to put into place some kind of formal mechanism for assessing agency decisions not to initiate a regulatory policy change. The comments submitted by Revesz and Livermore lay out a thoughtful proposal along these lines, and I am generally supportive of their suggestions, at least in broad terms. I would also recommend putting some sort of a mechanism in place whereby petitions to an agency to initiate a rulemaking are automatically forwarded to OIRA, and OIRA has the discretionary authority to request that the agency conduct a cost-benefit analysis of the proposed regulation (or some related set of proposed regulations). Perhaps a more dramatic suggestion would be the creation of some mechanism whereby agencies receive some benefit (perhaps an additional budgetary allocation) for every major rule they enact that OMB subjects to careful review and subsequently approves. If this reward were set at the right level, it would provide an incentive to act that would offset the disincentive created by the expected costs of OMB review.

I would also support the creation of some sort of mechanism by which, in those cases where OMB requests that the agency perform additional analysis on a proposed rule, OMB provide the agency with additional resources to conduct the analysis. The reason for this is that OMB does not internalize all the costs of requesting additional analysis from the agency, which may lead OMB to make excessive demands on agency's time and resources (even if everyone at OMB acts in perfectly good faith). The problem is akin to the problem of "unfunded mandates" in the legislative context. This may not be achievable by executive order, but if it were possible to secure appropriate legislation, it would be a good idea for OMB to have a (limited) pool of money that it would provide to agencies to conduct more rigorous analysis when OMB deemed such additional analysis necessary. This would force OMB to internalize more of the costs associated with its requests to agencies, and would make the prospect of OMB review less of a disincentive to action for agencies.